



Y2K Newsletter

MMillennium

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Welcome to the Y2K Newsletter

*By Ellen Seidman, Director,
Office of Thrift Supervision*

You would have to be on Mars to miss the repeated warnings about the potential catastrophe if we do not get our arms around the Year 2000 computer problem. Some doomsayers are projecting an inevitable mess because some businesses or other systems operators will be unprepared, and whoever or whatever interfaces with them will suffer.

We want to avoid any such situation in the thrift industry or elsewhere in the financial services business. The changeover problem is certainly real, but we can avoid the worst problems by judiciously preparing for the changeover now. Our goal is to ensure that any eleventh-hour glitches that do show up are minimal and manageable.

OTS takes every opportunity to keep you aware of the issues and to urge you to proactively address potential problems at your institution. We will continue to do so. This newsletter, to be published on a regular basis, is just one of the tools in our information arsenal. Other communications include the Year 2000 section of the OTS web page, and periodic advisory letters and policy statements. We have provided more information on the web page and other web sites of interest elsewhere in this issue. Resources also are available through your trade associations.

Time for preparation is moving along quickly, and by now, you should be well into the conversion and renovation phase of your Y2K project management plan. We are currently conducting the second round of Year 2000 examinations, which we expect to complete by July 1. It is essential that you complete your conversion and renovations efforts in a timely manner, thereby positioning your institution for what may prove to be the most critical phase of your program – testing. I can't stress too greatly the importance of being in compliance by the end of 1998 so every institution can devote next year to validating and testing all systems and fine tuning as necessary.

Many thrifts, particularly smaller ones, rely on outside service providers for their data processing needs. Like you, we have a keen interest in ensuring that these servicers are properly and promptly taking steps to ensure Year 2000 readiness. A forthcoming interagency paper will provide detailed guidance to help you manage your relationship with these providers. In the interim, we encourage you to work closely with your servicer and make certain the interests of your institution are understood, and that you have a firm place in your servicer's testing schedule. We ask that you continue to keep us apprised of any difficulties you experience along the way.

The Y2K Newsletter is published by the Office of Thrift Supervision in a continuing effort to prepare ourselves and the industry we serve to meet the challenges of the next millennium. Any comments, suggestions or requests for topical information should be addressed to your OTS Regional representative listed on the back page of this newsletter.

I also want to mention that OTS has been working diligently to get its own house in order. As of this writing, the agency has completed 85 percent of its necessary computer code renovations, and we expect to complete the task and then test our systems by the end of 1998.

There is an obvious urgency in preparing for the calendar rollover. The clock is ticking and cannot be stopped. Resources are scarce, so careful planning is absolutely essential. I hope every institution's officers and directors share that sense of urgency, and channel it into positive action for the benefit of their institution and their customers. Hopefully, this newsletter and our other communications will provide incentive, as well as helpful guidance, to get the job done. Communications is a two-way street, so we invite input on issues you believe are important and suggestions for making the newsletter worthwhile.

We especially invite your suggestions on whether the newsletter should include reader comments on issues such as products no longer supported, or unexpected – but likely to be non-unique – glitches in the conversion, renovation or testing process. In short, we'd like to hear from you.

Year 2000 Examinations Examined

One of the four key steps in the OTS comprehensive plan adopted in March 1997 to address potential computer system problems arising from the Year 2000 calendar rollover was to expand the examination process to include Year 2000 procedures. The other three steps involve 1) enhancing industry awareness; 2) providing active supervision to ensure that necessary system changes are effected by the end of 1998; and 3) monitoring the overall efforts toward following the plan and fulfilling the agency's responsibilities.

This article looks at our examination approach and what we have learned from our initial Year 2000 reviews.

Initial Year 2000 Examinations

During the summer and fall of 1997, OTS examiners conducted a special round of examinations of all OTS-regulated thrifts to assess thrift management's awareness of Year 2000 issues and their commitment to the timely resolution of those issues. OTS sent each institution a Year 2000 Project Management Awareness Assessment (PMAA) and requested it to return the completed assessment along with supporting documents to regional offices. Examiners then reviewed the information, made follow-up calls as necessary, and prepared a report for the institution. The examiners also completed a questionnaire that was entered into a national database, enabling OTS to assess industry-wide Year 2000 conditions.

The aggregate numbers show that the thrift industry generally is aware of and addressing the potential impact of Year 2000. For example, 94 percent of thrifts have assigned Year 2000 oversight duties to a senior officer or committee, and 90 percent were by the fall of 1997 developing a Year 2000 Action Plan. Based on the answers thrifts provided to their PMAAs and the breadth and depth of the supporting documentation, the examiners rated 85 percent of the thrifts as having average or better awareness and commitment to resolution.

As for renovation, conversion efforts, including those by service providers, are well under way for 45 percent of the industry. At the one percent of the industry that started Year 2000 projects early, renovation efforts are reportedly complete, subject only to additional testing of various interfaces with other parties.

The examiners rated each institution's overall risk to Year 2000. Bear in mind this evaluation was based on the examiner's perception of the institution's approach to Year 2000 – including its understanding of the issues and its planning for remediation – and not on an analysis of actual renovation, testing or implementation efforts. Subsequent examinations will delve into those areas. The overall ratings are as follows:

Risk Level	Number of Thrifts	% of Total	% Total Assets
Low Risk	63	5.3%	8.3%
Somewhat Low Risk	248	20.8%	38.0%
Average Risk	714	59.8%	39.8%
Somewhat High	140	11.7%	13.5%
High	28	2.4%	0.4%

The differences in the percentages reported coincide with the finding that smaller thrifts generally have not addressed Year 2000 matters as aggressively as larger ones. While 42 percent of the thrifts with assets of \$1 billion or more received a less-than-average risk rating in their approaches to Year 2000, only 22 percent of institutions with under \$100 million in assets and 28 percent with assets between \$100 million and \$1 billion received that rating. To be sure, there are some small and medium-size thrifts with excellent Year 2000 Action Plans and some large thrifts whose efforts were found lagging in one or more respects. But a relatively high percentage of smaller thrifts have yet to demonstrate a vigorous approach to Year 2000 oversight and remediation.

Comments by examiners in support of the assigned ratings of “high” and “somewhat high” risk most often noted the absence of Action Plans and the reliance on vendors that was not buttressed by due diligence. Other common concerns for these shops and for some shops assigned an “average risk” rating involved incomplete Action Plans, inadequate planning for testing, and the absence of contingency planning. In addition, examiners often found that institutions had planned for computer conversion, but had not yet started the assessment of other items, such as phones and environmental controls (HVAC), that can be adversely affected by the calendar year rollover. They further detected some lack of understanding about interfaces and about credit risk. Finally, even for those serviced institutions attempting due diligence, information obtained to date from vendors did not always provide sufficient information about renovation approaches and testing opportunities and plans.

The concerns noted by OTS examiners are similar to those of examiners from the other regulatory agencies. To address these concerns, OTS, OCC, FDIC and National Credit Union Administration (NCUA) are working together under the auspices of the FFIEC to issue additional guidance. Policy statements now being drafted discuss the due diligence process for reviewing the performance of vendors; testing strategies and methodologies for institutions with in-house data centers and for those serviced by third parties; and the management of risks arising from Year 2000 exposure borne by large borrowers and other corporate customers.

In sum, the first round of Year 2000 examinations reveals that the thrift industry is taking the appropriate first steps toward timely resolution of potential problems. Though much work remains, the goal of the calendar year rollover occurring without disruption to the industry, its customers and the general public appears to be attainable provided thrift managements devote the necessary resources and oversight in the next 23 months to their own internal changeover activities and to those of their service providers.

On-Going Year 2000 Examinations

OTS examiners will continue to review Year 2000 matters at all regularly scheduled examinations until all the problems posed by the calendar rollover are handled or otherwise dispelled. The examiners will use the FFIEC examination program for Year 2000 that was previously provided to the industry through CEO Letter #67. The program also is available on the OTS web page at www.ots.treas.gov and through PUBLIFAX at (202) 906-5660.

Because of the urgency surrounding the Year 2000 changeover, there will be special targeted examinations or field visits focusing on specific activities. In particular, any institution that does not have a regular safety and soundness examination scheduled before mid-June 1998 will, nonetheless, be scheduled for a Year 2000 field visit. These examinations, be they regular or field visits, will follow up on any concerns identified in the initial off-site examination. They will cover a full range of Year 2000 matters, but will focus especially on renovation efforts of the thrift and/or its service providers and plans for testing.

Year 2000 Examinations of Service Providers

The FFIEC examination program is also being used by Information Systems (IS) examiners from all the banking regulatory agencies in their examination of third party vendors (service bureaus) and shared application software providers. Whether these entities are examined by OTS, another agency, or a team of examiners from several agencies depends on the client base of the third party entity. A vendor with client financial institutions regulated by the OTS, FDIC and OCC, for example, would be examined by a team of IS examiners from those three agencies.

Similar to the plan for thrifts, OTS has accelerated the examination schedules to accommodate regular or special IS examinations of vendors by June 1998.

Publicly Traded Thrifts Have To Make Disclosure; Others Urged To

OTS-regulated thrift institutions that are publicly traded must disclose in their annual report filings their Year 2000 compliance activities, following guidelines set forth by the Securities and Exchange Commission (SEC). Recently, the SEC revised its guidelines, originally issued last October, and reported them in Staff Legal Bulletin No. 5, which is summarized below. Essentially, the requirement is that these institutions disclose in their annual filings the status of their preparation for the Year 2000 changeover.

The agency sent letters in November to 16 thrifts that have fiscal years ending September 30 reminding them that the agency will be looking for their Y2K disclosures. At the same time, the staff identified 44 major legal and accounting firms that process more than 95 percent of all filings and sent them a letter requesting that they remind their clients of the requirements.

More recently, letters and the recently revised SEC guidelines were sent to 37 thrifts whose year ended December 31. OTS has reminded institutions that the agency wants adequate disclosure, not boiler plate language. Moreover, the agency has advised all of these thrifts to include the disclosure whether they consider the activities material or not; OTS does consider Y2K activities material. OTS has instructed all initial public offering filers to include or expand their Y2K disclosures.

The SEC revised its staff bulletin on Y2K disclosure January 12. The revised bulletin provides registrants additional guidance in more specific terms than was contained in the original bulletin issued last October. Since OTS wants all Y2K-related matters disclosed, filing thrifts will have to include the following in the Management's Discussion & Analysis section of their annual report:

- ◆ The nature and potential impact of Year 2000 issues, as well as any countervailing circumstances;
- ◆ The company's general plans to address Year 2000 issues, including relationships with customers, suppliers and other constituents;
- ◆ The timetable for carrying out the general plans;
- ◆ The total dollar amount that the company estimates it will spend to remediate its Year 2000 issues; and
- ◆ Any impact that Year 2000 expenditures are expected to have on the company's results of operations, liquidity and capital resources.

Additional disclosure requirements for companies may be applicable in the Description of Business section of annual and other periodic reports or in a Form 8-K, which is used during the year when needed to cover current significant events. In addition, the SEC staff bulletin reiterates accounting guidance from FASB's Emerging Issues Task Force that costs associated with modifying internal-use software for the Year 2000 should be charged to expense as incurred.

OTS also urges other institutions to use the SEC guidance as the basis for making their owners – whether they are a limited group of investors, or mutual account holders – aware of their Y2K progress. The SEC Staff Legal Bulletin No. 5 is available on the SEC's web site at www.sec.gov.

Odds and Ends

We are listing in this first issue of the MMillennium the names of OTS contacts in Washington and in each of the agency's five regions. You may call upon them for advice and assistance, and they will try to be as helpful to you as they can. They cannot, however, do the detailed work that needs to be done at each institution to bring it into Y2K compliance. In each succeeding issue, the contact names will appear for your convenience.

Dorothy Van Cleave is the Year 2000 national coordinator, and Jennifer Dickerson is the information systems program manager. They are providing OTS staff throughout the nation counsel and support on Y2K examination and supervision. Both are based at OTS headquarters in Washington, but they will frequently travel to the various OTS regions to carry out their mission. Their address is 1700 G. Street NW, Washington, DC 20552. Ms. Van Cleave's phone number is (202) 906-7380, and Ms. Dickerson's is (202) 906-5631. Their fax number is (202) 906-5735.

Ms. Van Cleave is a national examiner for OTS. She formerly was an outreach manager of the Examination Oversight/Outreach Program of OTS and before that, an assistant regional director based first in Topeka, Kansas, and then in Kansas City. She began her career as an examiner in 1972.

Following are the contacts in each of the OTS regions:

Region	Y2K Contact	Title	Phone Number	Fax Number
Northeast	Vincent J. Buono, Jr.		(201) 413-7361	(201) 413-7543
	Tri Ma Gia	IS Manager	(201) 413-7510	
	Robert DeTullio	Regional Accountant	(201) 413-5894	
	<i>10 Exchange Place, 18th Floor; Jersey City, NJ 07302</i>			
Southeast	Robert J. Cohrs	Assistant Director	(404) 888-8550	(404) 888-5634
	Laurin J. Tidwell		(404) 888-8486	
	Jeff Geer	Regional Accountant	(404) 888-5363	
	<i>1475 Peachtree Street, NE; Atlanta, GA 30309</i>			
Central	Daniel T. McKee	Regional Dep. Director	(312) 917-5071	(312) 917-5002
	Thomas J. Zarecki	IS Examination Mgr.	(312) 917-5073	
	Dennis Thomas	Regional Accountant	(312) 917-5088	
	<i>200 West Madison Street, Suite 1300; Chicago, IL 60606</i>			
Midwest	Gary A. Scott	Assistant Director	(972) 281-2234	(972) 281-2073
	Chuck Bianco	IS Manager, EDP Oversight & Support	(972) 281-2145	
	Frank Haugh	Regional Accountant	(972) 281-2125	
	<i>122 W. John Carpenter Freeway, Suite 600; Irving, TX 75039</i>			
West	Nicholas J. Dyer	Asst. Regional Director	(415) 616-1521	(415) 616-1752
	Paley Y. Pang	IS Manager	(415) 616-1554	
	Mary Garvin	Regional Accountant	(415) 616-1611	
	<i>One Montgomery Street, Suite 600; San Francisco, CA 94104</i>			



Countdown 2000: Is your Bank Really Ready?

The OTS and the FDIC are cooperating with America's Community Bankers in putting on three conferences in the next two months in three cities.

Washington
February 19 and 20

Los Angeles
February 26 and 27

Chicago
March 9 and 10

Day One

Starting at 10 a.m., the first day's session will cover such topics as

- ◆ the anatomy of the Y2K problem
- ◆ an examiner's view of Y2K featuring OTS examiner Jennifer Dickerson
- ◆ seriousness of the problem
- ◆ identifying and correcting in-house computer systems

Day Two

Which ends at noon, will deal with

- ◆ Y2K legal perils and protections
- ◆ testing
- ◆ contingency planning.



OTS will periodically update its Year 2000 section on its web page, including a version of this newsletter, in the ongoing program to provide helpful information. The web site also links to other pertinent web sites such as that of FFIEC. You can access the OTS page at www.ots.treas.gov. The web page Y2K section currently includes, among other things, the FFIEC Y2K guidelines that were issued in December and the checklist for monitoring progress in your Y2K plan.

Other web sites of possible interest to readers are those of America's Community Bankers (ACB) at www.acbankers.org and the Independent Bankers Association of America (IBAA) at www.ibaa.org.

You may also find a publication of the American Institute of Certified Public Accountants (AICPA) helpful in assessing your Y2K program. This 40-page publication, entitled "The Year 2000 Issue: Current Accounting and Auditing Guidance," provides a brief overview of the Y2K issue, and summarizes the applicable accounting, disclosure and auditing standards. The publication relates the responsibilities of various parties, clarifies the auditor's role, provides guidance on auditor communications with clients, and describes disclosure considerations and certain practice management matters that auditors may wish to consider in connection with the Year 2000 issue. The publication is available on the AICPA's web page at www.aicpa.org and can be obtained from the AICPA through its toll-free number (800) 862-4272.